

Internal Revenue Service

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Department of the Treasury
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Refer Reply To:
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PLR-108151-10
Date:
June 02, 2010

Employer:

Plan:

Trust:

Board:

Year 1:

Year 2:

Year 3:

Year 4:

Law:

Entity:

County:

State:

PLR-108151-10

Dear :

This letter responds to a letter from your authorized representative dated January 31, 2010, as well as subsequent correspondence, submitted on behalf of the Employer, requesting rulings that the Trust's income is excludable from gross income under § 115 of the Internal Revenue Code (Issue 1) and that the Trust is not required to file an annual income tax return (Issue 2). The Employer represents the following facts.

FACTS

Employer is a public retirement system created in Year 1 by vote of the citizens of the County in accordance with the Law. Its function is to administer retirement benefits for the employees of the County and other public agencies within the State.

Employer is managed by the Board, the majority of which is composed of the County treasurer and members appointed by the County board of supervisors, and the balance of which is elected by current and retired members of the Employer.

Prior to Year 2, the Employer operated as a department of the County, with its executive management staff, investment staff, and certain supervisory personnel (Management) working as employees of the County. In Year 2, however, the Board passed a resolution adopting recently enacted State code provisions making the Employer an Entity. As such, the Employer now is a political subdivision of the State, employing Management directly (as of Year 3), while continuing to perform the same function as before. All of the Employer's administrative staff other than the Management continue to be employed by the County.

In Year 4, the Employer established the Plan to provide certain of its employees, as well as their spouses, dependents, and domestic partners (Beneficiaries) with reimbursement for qualified medical expenses after retirement. The Trust to fund the Plan was established the same year.

The Employer contributes 2% of each participant's earned incentive plan award. Contributions are mandatory and continue until the participant's separation from service, at which time the Employer contributes 100% of the current value of each participant's unused accumulated sick leave. Employees have no elections as to Plan participation or contribution levels. Contributions are allocated to separate participant accounts.

PLR-108151-10

A participant must terminate employment with the Employer to receive benefits, which consists of reimbursements for qualified medical expenses under § 213(d)(1), to be made from the participant's account. The maximum benefit equals the participant's account balance. Upon the death of the participant, his Beneficiaries are entitled to benefits under the Plan. Any balance in the account after the death of the retiree and of all Beneficiaries is forfeited.

The Plan administrator is the Employer or a person selected by the Employer. The Employer may amend the Plan document at any time, subject to ensuring that Trust assets are used for the exclusive benefit of participants and Beneficiaries and for reasonable administrative expenses. On Plan termination, any assets remaining after all Plan liabilities are satisfied will revert to the Employer.

The trustee of the Trust is the Employer's executive director and chief investment officer. Trust distributions are made only as directed by the administrator. The trustee determines investments, and he may engage investment advisors. The trustee maintains accounts, and reports all transactions to the Employer. The trustee receives no compensation beyond his pay as an employee.

The Employer can replace the trustee at any time with 30-day written notice. It can amend the Trust agreement at any time and at any time terminate the Trust. (The Employer represents that the Trust provision allowing for retroactive amendments will be deleted.) Upon termination, after all benefits owed and all expenses have been paid, any assets remaining revert to the Employer.

The Plan and the Trust provide for reimbursement of qualified medical expenses incurred by, *inter alia*, a participant's domestic partner. Under the Plan, the value of any benefits to be provided to a nondependent domestic partner will be included in the participant's income as the benefits are earned rather than when paid, to the extent required by the Code.

LAW AND ANALYSIS

ISSUE 1

Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from

PLR-108151-10

gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) was excludable from gross income under § 115. In Rev. Rul. 90-74, private interests neither materially participated in the organization nor benefited more than incidentally from the organization.

The Trust was established and is maintained by the Employer to provide various health benefits under the Plan to its retired employees and their Beneficiaries. Providing such benefits to former public employees constitutes the performance of an essential governmental function within the meaning of § 115(1). See Rev. Rul. 90-75 and Rev. Rul. 77-261.

The provision of health benefits to participating retirees and their Beneficiaries satisfies the obligation of the Employer under the Plan to provide those benefits; thus, the income of the Trust accrues to the benefit of the Employer, which is an agency of the State. No private interests participate in, or benefit from, the operation of the Trust, other than as providers of goods and services. Any amounts remaining in the Trust after all health benefits, plus reasonable fees and expenses, have been paid shall be returned to the Employer. The benefit to retired employees is incidental to the public benefit. See Rev. Rul. 90-74.

LAW & ANALYSIS ISSUE 2

Section 301.7701-1(b) of the Procedure and Administration regulations provides, in part, that the classification of organizations that are recognized as separate entities is determined under §§ 301.7701-2 through -4, unless a provision of the Code provides for special treatment of that organization.

Section 301.7701-4(a) of the regulations provides, in general, that an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

The Employer contributes money to the Trust to pay health benefits for certain retired employees of Employer and their Beneficiaries. The trustee is charged with protecting and conserving the Trust's assets for Trust beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of a business for profit. Assuming that the Trust is recognized as a separate entity under § 301.7701-1, we conclude that the Trust is an ordinary trust under § 301.7701-4(a).

Section 6012(a)(4) provides that every trust having taxable income for the tax year, or having gross income of \$600 or more for that year regardless of the amount of taxable income, must file a return with respect to income taxes under subtitle A.

CONCLUSION

Based solely on the facts and representations submitted by the Employer, and as of the date the proposed amendment to the Trust agreement is adopted:

1. We conclude that the income of the Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Consequently, we rule that the Trust's income is excludable from gross income under § 115(1).
2. Assuming that it is a separate entity under § 301.7701-1, we conclude that the Trust is classified as an ordinary trust under § 301.7701-4(a). Section 6012(a)(4) does not require a trust without taxable income to make a return of income when gross income is less than \$600. Because the Trust's income is excludable from gross income under § 115(1), we rule that the Trust is not required by § 6012(a)(4) to file an annual income tax return.

Except for the specific rulings above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding the federal tax consequences of contributions to, or payments from, the Plan, including whether contributions to the Plan are excludable from the gross income of employees, former

PLR-108151-10

employees, retirees, spouses or dependents under § 106 and whether payments from the Plan (including reimbursements of medical expenses) are excludable from the gross income of employees, former employees, retirees, spouses, or dependents under §§ 104 or 105.

Under a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Sincerely,

SYLVIA HUNT
Assistant Chief
Exempt Organizations Branch 2
Office of Division Counsel /
Associate Chief Counsel
(Tax Exempt & Government Entities)

enclosures: copy for § 6110 purposes